COMMUNITY DENTAL SERVICES, INC.
(dba SmileCare Dental Group)
Notes to Financial Statements
June 30, 2003 (Unaudited) and December 31, 2002

(1) Accounting Policies

Description of Business

Community Dental Services, Inc. (the "Company") was incorporated in 1979 in the state of California as a specialized health care service plan licensed under the Knox-Keene Health Service Plan Act of 1975, as amended ("Knox-Keene"). The Company operates a network of 56 dental service facilities. The Company offers a full range of routine dental services and specialty services including orthodontics, periodontics and oral surgery.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Net Patient Service Revenues

The Company serves patients whose dental care is paid under a variety of financial arrangements. The types of payment arrangements are customary to the dental care industry. Revenues are recorded at the predetermined fee schedule amount, which June differ for the same procedure between insurance carriers, and are recognized as the services are provided.

Premiums Earned

The Company markets its own dental coverage plans. These coverages include supplemental plans which compliment primary qualified plans by covering co-payments and deductibles. Also, the Company markets primary dental coverage. Premium revenue is recognized in the month in which the enrollees are entitled to receive dental care services. Premiums for individual plans are billed annually and recorded as unearned premiums until earned. Premiums for group plans are billed monthly and recognized in the month earned.

Income Taxes

Deferred Tax assets and liabilities are recognized based upon the difference between the financial statement and tax bases of assets and liabilities, using enacted tax rates in effect for the year in which the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

Property, Plant and Equipment

Property, plant and equipment are stated at historical cost. Depreciation and amortization is calculated using the straight-line method. Buildings are depreciated over 19 to 35 years, equipment over 5 to 8 years, furniture and fixtures over 7 years and vehicles over 5 years. Leasehold improvements are amortized over the shorter of the useful life or the term of the lease.

Cash Equivalents

There were no cash equivalents at June 30, 2003 or December 31, 2002. For purposes of the statements of cash flows, the Company considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents.

Short-Term Investments

Short-term investments are comprised of investments with original maturities in excess of three months. Investments are carried at cost which approximate market value.

Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of

The Company adopted the provisions of Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets to Be Disposed Of", on January 1, 1996. This statement requires that long-lived assets and certain identifiable intangibles be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset June not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. Adoption of this statement did not have a material impact on the Company's financial position, results of operations or liquidity.

Reclassifications

Certain classifications of prior period amounts have been reclassified to conform to the current year presentation.

(2) Property, Plant and Equipment

Property, plant and equipment as of **June 30, 2003** consisted of the following, net of accumulated depreciation (in thousands):

Land and Building	$	2,813
Equipment		1,983
Computer Equipment		536
Leasehold Improvements		1,803
	$	7,135

(3) Long-Term Debt

A summary of debt outstanding at June 30, 2003 and December 31, 2002 is as follows (in thousands):

	2003	2002
Loans and Notes Payable (Not Subordinated):		
Capital Leases	$ 187	$ 236
Senior revolving loan converted to term note, at prime plus 2%, secured by total assets; interest due monthly, balance due in full on May 31, 2005	2,000	2,000
Senior revolving loan, at prime plus 1%, secured by accounts receivable and a building owned by the Company; total commitment of $6,500,000; interest due monthly, balance due in full on October 27, 2003	6,254	6,273
Sub-total	8,441	8,509
Loans and Notes Payable (Subordinated):		
Senior term note, subordinated at prime plus 2%, secured by total assets; principal payable in varying quarterly installments commencing September 30, 2001, due in full on December 31, 2005	26,250	26,250
Subordinated note at prime plus 4%, secured by total assets; principal and interest due in full on March 31, 2006	15,000	15,000
Other	2,045	2,376
Less unamortized debt discount	(293)	(377)
Sub-total	43,001	43,249
Total loans payable	$ 51,443	$ 51,758

(4) Commitments and Contingencies

The Company has various noncancelable operating leases. Initial lease terms range from 2 to 21 years, but provide for renewal options. Rent expense through June 30, 2003 and for the year ended December 31, 2002 was $2,658,000 and $5,138,000 respectively.

Future minimum lease payments under noncancelable operating leases as of June 30, 2003 are as follows (in thousands):

2003	$ 2,530
2004	2,956
2005	2,103
2006	1,159
2007	536
Thereafter	892
Total minimum lease payments	$ 10,176

The Company maintains malpractice liability insurance, on a claims made basis, in the amount of $3,000,000 per occurrence and $3,000,000 in the aggregate. This insurance supplements insurance maintained by the independent contracting dentists engaged by the Company. Independent contracting dentists, as a term of their engagement, maintain malpractice insurance policies which insure each dentist for an annual aggregate minimum of $1,000,000. Additionally, the Company provides insurance of $1,000,000 per occurrence and $3,000,000 in the aggregate, on a claims-made basis, for an officer and shareholder of the Company for directing the general course of treatment provided by the independent contractors.

The Company is involved in various claims and legal actions arising in the ordinary course of business. In the opinion or management, the ultimate disposition of these matters will not have material adverse impact on the financial position of the Company.